APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 97-2152

TRAFALGAR CAPITAL ASSOCIATES, INC., ETC.

Plaintiff-Appellee,

v.

ANDREW CUOMO, ETC.,

Defendant-Appellant.

EXECUTIVE OFFICE OF COMMUNITIES AND DEVELOPMENT, ET AL.,

Defendants-Appellees.

No. 97-2153

TRAFALGAR CAPITAL ASSOCIATES, INC., ETC.,

Plaintiff-Appellant,

v.

ANDREW CUOMO, ETC., ET AL.,

Defendants-Appellees.

Before

Torruella, *Chief Judge,*
Coffin and Aldrich, *Senior Circuit Judges,*
Selya, Boudin, *, Lynch and Lipez, *Circuit Judges.*

ORDER OF COURT

Entered: December 30, 1998

The panel of judges that rendered the decision in these cases having voted to deny the petition for rehearing and the suggestion for the holding of a rehearing en banc having been carefully considered by the judges of the Court in regular active service and a majority of said judges not having voted to order that the appeals be heard or reheard by the Court en banc,

It is ordered that the petition for rehearing and the suggestion for rehearing en banc be denied.

BY THE COURT,

PHOEBE MORSE, Clerk.
By /s/ Janice M. O'Neil
Chief Deputy Clerk.

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*Judge Norman H. Stahl, did not participate.

cc: Ms. Simon
Mr. Coan

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TRAFALGAR CAPITAL ASSOCIATES, INC., ETC.,
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Defendants-Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
[HON. JOSEPH L. TAURO, *U.S. DISTRICT JUDGE*]

BEFORE

Selya, *Circuit Judge*,

Aldrich and Coffin, *Senior Circuit Judges*.

Maria Simon, Attorney, Appellate Staff, with whom *Frank W. Hunger*, Assistant Attorney General, *Donald K. Stern*, United States Attorney, and *John F. Daly*, Attorney, Appellate Staff, were on brief for Andrew Cuomo, Etc.

Carl A.S. Coan, Jr., with whom *Carl A.S. Coan III*, was on brief for Trafalgar Capital Associates, Inc.

October 29, 1998

COFFIN, *Senior Circuit Judge*. The United States Department of Housing and Urban Development ("HUD") agreed to subsidize a portion of tenants' rents in a housing rehabilitation project owned by the Heywood-Wakefield Associates Limited Partnership ("Heywood-Wakefield"). Appellee/cross-appellant Trafalgar Capital Associates, Inc. ("Trafalgar"), the general partner of Heywood-Wakefield,[1] complained that HUD miscalculated the amounts to which the project was entitled. Upon cross-motions for summary judgment, the district court found that three decisions by HUD were arbitrary and capricious and that Trafalgar's claim on a fourth HUD decision was barred by the statute of limitations. We hold that the district court erred on two of the claims, but correctly ruled for HUD on the third and on the statute of limitations. We accordingly affirm in part, and reverse in part.

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[1]In federal court in Massachusetts, an action on behalf of a limited partnership must be brought in the name of its general partner. *See* Fed. R. Civ. P. 17(b); *Roberts-Haverhill Assoc. v. City Council of Haverhill*, 319 N.E.2d 916, 920 (Mass. App. Ct. 1974). Trafalgar, as a general partner of Heywood-Wakefield, filed suit on behalf of the partnership. For the sake of simplicity, we will use "Trafalgar" to refer to both Trafalgar and Heywood-Wakefield.

I. *Background*

A. *Statutory Scheme*

HUD agreed to subsidize Trafalgar's project under the Moderate Rehabilitation Program, 42 U.S.C. § 1437f(e)(2), one of the programs under Section 8 of the United States Housing Act of 1937, 42 U.S.C. § 1437f ("Section 8").[2] The Moderate Rehabilitation Program is designed to encourage private individuals to rehabilitate low and moderate income housing through the award of rent subsidies. Under the program, HUD contracts with local public housing agencies, which in turn contract with the project owners who rehabilitate the property. Regulations require the local public housing agency to secure a preliminary contract with the project owner prior to rehabilitation, and a permanent agreement once the rehabilitation is completed and the units are ready for occupancy.

Both the preliminary agreement, known as the "AHAP," or Agreement to Enter into a Housing Assistance Payments contract, and the permanent agreement, known as the "HAP," or Housing Assistance Payments contract, set a "contract rent" based on the applicable regulations. *See* 24 C.F.R. § 882.408 (1998). Residents eligible for Section 8 housing are required to pay rent based on their monthly income. *See* 42 U.S.C. § 1437a(a). HUD pays the owner the difference between the "contract rent" and the amount the resident pays. *See* 42 U.S.C. § 1437f(c)(3)(A).

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[2]The Moderate Rehabilitation Program was eliminated as of October 1, 1991, but existing projects were allowed to continue. *See* Cranston-Gonzalez National Affordable Housing Act, tit. II, subtit. F, § 289(a)(4), (b), Pub. L. No. 101-625, 104 Stat. 4079, 4128. For ease of reference, we will cite to regulations from the most recent Code of Federal Regulations where the language in effect at the time is the same.

The contract rent is based on two components: 1) the "monthly rehabilitation debt service," which covers the cost of rehabilitation; and 2) the "base rent," reflecting the cost of owning, managing, and maintaining the property independent of rehabilitation costs. *See* 24 C.F.R. § 882.408(c)(2) (1998). The base rent is also allowed to incorporate a reasonable return on investment. HUD Handbook 7420.3 ("HUD Handbook"), p. 2. Both the base rent component and the contract rent total are subject to market-based ceilings, and are adjusted annually.[3] *See* 42 U.S.C. § 1437f(c); 24 C.F.R. § 882.410(a)(1) (1998). The base rent is ordinarily capped at the Existing Housing Fair Market Rent ("FMR"), and the contract rent has a ceiling of 120 percent of the relevant FMR. *See* 42 U.S.C. § 1437f(c); 24 C.F.R. § 882.408(a)(1998). FMRs, published annually by HUD, are based on an analysis of the rents charged for similar standard units in the same general geographic region. *See* 42 U.S.C. § 1437f(c).

In certain situations HUD can approve increases for costs not sufficiently taken into account in the contract rent calculation. An "exception rent" may be granted if the FMR does not accurately reflect the actual rents charged in the project's "specified area," meaning its more narrowly defined geographic region. *See* 24 C.F.R. § 882.408(b) (1998), HUD Handbook, Ch. 10, 10-2(c) (1). If HUD approves such an exception rent, the owner may charge an additional 10 percent over the usual contract rent ceiling. *See* 24 C.F.R. § 882.408(b) (1998).

B. *Facts*

In February 1984, Trafalgar filed its proposal with HUD to

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[3]The monthly rehabilitation debt service is based solely on rehabilitation costs spread over the term of the HAP, and is not adjusted annually.

convert an abandoned furniture factory in Gardner, Massachusetts into moderate income housing. The preliminary AHAP for the project was executed on April 30, 1986, with a retroactive effective date of February 8, 1986. The rehabilitation proceeded in four stages. After the fourth stage was completed, the final portion of the permanent HAP was executed on April 17, 1990.

Trafalgar also has a contract in connection with the same project to receive more than $1.1 million in assistance over 15 years from a state program known as the Massachusetts State Housing Assistance for Rental Production ("SHARP") program.

Trafalgar believed that HUD made several incorrect decisions that had the effect of reducing the subsidies to which Trafalgar was entitled. After lengthy correspondence and proposals to revise the HAP, Trafalgar brought this action under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551-59, 701-6, and the Declaratory Judgment Act, 28 U.S.C. § 2201. Trafalgar's complaint charged four errors: (1) HUD erroneously excluded costs incurred before the AHAP; (2) HUD improperly refused to raise the rent after offsetting errors were discovered; (3) HUD mistakenly characterized the Massachusetts SHARP assistance as a grant rather than a loan; and (4) HUD incorrectly used the 1985 FMR instead of the 1986 FMR. Upon cross-motions for summary judgment, the district court ruled that HUD's decisions on the first three issues were arbitrary and capricious, but that Trafalgar's claim on the fourth was barred by the statute of limitations. Both parties appealed.

Additional facts will be developed in subsequent sections as they become relevant.

II. *Discussion*

This court reviews the district court's grant of summary judgment *de novo*, viewing the facts in the light most favorable to the non-moving party. *See FDIC v. Kane*, 148 F.3d 36, 38 (1st Cir. 1998). We can affirm only if "the record discloses no trialworthy issue of material fact and the moving party is entitled to judgment as a matter of law." *EEOC v. Green*, 76 F.3d 19, 23 (1st Cir. 1996).

With respect to the three HUD decisions, they can only be set aside if they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). When exposed to judicial review, HUD's decisions are entitled to "great deference" and are presumed valid. *Associated Fisheries of Maine, Inc. v. Daley*, 127 F.3d 104, 109 (1st Cir. 1997). The court must affirm HUD's decisions if they are "reasoned, and supported by substantial evidence in the record." *Id.* "Although searching and careful, review under the 'arbitrary and capricious' standard is narrow in scope." *Pan Am. Grain Mfg. Co. v. E.P.A.*, 95 F.3d 101, 103 (1st Cir. 1996). The court may not substitute its judgment for that of the agency, and agency decisions will be upheld so long as they "do not collide directly with substantive statutory commands and so long as procedural corners are squarely turned." *Adams v. E.P.A.*, 38 F.3d 43, 49 (1st Cir. 1994). The court's deference to HUD's decisions "is magnified when the agency interprets its own regulations." *Puerto Rico Aqueduct & Sewer Auth. v. E.P.A.*, 35 F.3d 600, 604 (1st Cir. 1994). While this standard of review is highly deferential, "it is not a rubber stamp." *Citizens Awareness Network, Inc. v. U.S. Nuclear Regulatory Comm'n*, 59 F.3d 284, 290 (1st Cir. 1995). To avoid being found arbitrary and capricious, HUD's decision must be rational; that is it "must make sense to [the] reviewing

court[]." *Puerto Rico Sun Oil Co. v. E.P.A.*, 8 F.3d 73, 77 (1st Cir. 1993).

Whether the statute of limitations barred Trafalgar's claim regarding the relevant FMR is an issue of law, and that aspect of the district court's decision will be reviewed *de novo*. *See American Airlines, Inc. v. Cardoza-Rodriguez*, 133 F.3d 111, 125 (1st Cir. 1998).

A. *Whether HUD improperly excluded costs incurred before February 8, 1985 from the rent calculation.*

Although HUD regulations require that the parties execute an AHAP before the owner begins rehabilitation, *see* 42 C.F.R. § 882.505 (1998), Trafalgar started work before executing such an agreement. When the public housing agency overseeing rehabilitation learned of Trafalgar's failure to enter into the AHAP, it ordered rehabilitation halted, and a meeting was called on February 5, 1986. At that meeting the parties agreed to execute an AHAP, which they finally did on April 30, 1986. Because it was clear that the AHAP would be executed, and the parties wanted rehabilitation to continue, they agreed at the meeting to backdate the AHAP to February 8, 1986, three days hence.

Between the date the proposal was submitted and February 8, 1986, Trafalgar had spent about $1.6 million on rehabilitation. At the February 5 meeting the parties discussed how these funds might be incorporated into the amounts Trafalgar could recover from HUD, but they evidently did not settle the specific method for doing so.[4] HUD, however, later

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[4]There is scant evidence of the parties' actual agreement at the February 5 meeting. The most contemporaneous evidence was a February 12 letter from the Massachusetts Executive Office of Communities and Development to Trafalgar containing "a summary of [the] discussion."

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determined that regulations barred including the $1.6 million in the subsidy calculations. The district court ruled that HUD's apparent reversal was arbitrary and capricious. Our review persuades us to the contrary.

It is undisputed that Trafalgar's pre-AHAP costs could only be incorporated into the base rent section of the contract rent because the monthly rehabilitation debt service may include only the rehabilitation costs incurred after the AHAP's effective date. Trafalgar argues that the amount should be allowed under either of two different sub-parts of base rent: the property debt service or return on investment. HUD argues that the structure and language of the regulations prohibit it from including the disputed costs in either category. We consider each possibility in turn.

1. *Property Debt Service.* HUD denied Trafalgar's request that the expenses be included in the property debt service on the ground that that component is temporally limited to costs incurred before the project proposal is submitted to HUD. Trafalgar argues that the regulations and HUD Handbook impose no such limitation. Each side cites language in the HUD Handbook to support its position.

The Handbook sets forth detailed guidelines to which HUD must adhere in setting the terms of an AHAP and a HAP. It includes a form for calculating the base and contract rents, as

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[4](...continued)
(App. at 151-53). In that letter, EOCD noted that, subject to HUD approval, the rent calculations could include costs expended to date if those costs came from "actual cash equity." Hence, the importance of "actual cash equity" was apparent to the parties at the time. *See infra* pp. 11-13. In its motion for summary judgment, Trafalgar submitted an affidavit of its president, William H. Berg. The affidavit, sworn to more than a decade after the meeting, states that the previously included costs "would be included" in the rent calculations, but fails to state how that would be accomplished.

well as extensive instructions on how to complete the form. HUD points to the "property debt service" instructions, which require the owner to "[e]nter the annual principal and interest (P & I) payments for loans related to purchase and improvement of the property *at the date of proposal submittal.*" HUD Handbook, p. 9 (emphasis omitted and added).

Trafalgar, in response, looks to the general overview language, which states that the base rent should reflect the "[a]nnual expenses for property debt service, insurance, taxes, utilities, management, and maintenance, *projected to the date of HAP contract execution.*" HUD Handbook, p. 2 (emphasis added). However, Trafalgar neglects to mention that the Handbook describes this overview as a "brief summary," and notes that "[d]etailed instructions are contained in the rent calculation formats." *Id.* The fact that the overview language states that a variety of costs should be calculated to the date of the HAP contract execution does not alter Trafalgar's obligation to comply with the specific instructions on how those calculations are to be performed. As HUD recognizes, the provision allowing for annual expenses to be "projected to the date of HAP contract execution," is HUD's method of acknowledging that estimated increases in operating costs should be included.[5] The provision does not authorize inclusion of rehabilitation costs, or any other costs not otherwise within the instructions for property debt service.

The well-known canon of statutory construction that the specific governs the general dictates the same result. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384-85 (1992); *Lloyd v. FDIC*, 22 F.3d 335, 337 (1st Cir. 1994). The specific limitation that property debt service includes only costs

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[5]The detailed instructions for operational costs such as insurance and taxes confirm this view. *See* HUD Handbook, p. 11.

prior to proposal submission trumps the general language that the costs should be calculated through the date of HAP execution.

Not only the Handbook's language but also the logic of the subsidy program supports HUD's position. In essence Trafalgar argues that the $1.6 million is recoverable as part of the property debt service regardless of when it was spent. This approach would justify inclusion of the same costs in two parts of the contract rent. If Trafalgar had followed the HUD regulations and executed an AHAP prior to beginning rehabilitation, the costs would have been includable in the monthly rehabilitation debt service component. Its argument here is that they are also recoverable under the property debt service sub-part of base rent. Trafalgar's argument assumes a redundancy in the Handbook, and deprives the distinction between rehabilitation debt service and base rent of any sense. The structure of the subsidy calculations confirms the conclusion that Trafalgar is not entitled to recover these pre-AHAP rehabilitation costs as part of the property debt service.

2. *Return on Investment*. The only other possible method for recovering these costs is including them as part of "an adequate return on the owner's investment." HUD Handbook, p. 2. In general, return on investment is limited in the same manner as the property debt service: it is capped at "the owner's actual cash equity in the property *at the time of proposal submission*." HUD Handbook, p. 13 (emphasis added). However, the notes detailing how to calculate return on investment create a narrow exception for post-proposal, pre-AHAP investment.

Under the Handbook the return on investment element may include post-proposal costs if two conditions are met: 1) a "prolonged period [must have] elapsed between proposal

submission and [AHAP] execution;" and 2) consistent with other requests for return on investment, the costs must be expended from "actual cash equity." HUD Handbook, p. 13. Actual cash equity is defined as the cost of capital expenditures less the outstanding indebtedness. *See id.* Taking these provisions together, the owner may capture an adequate return on investment for rehabilitation undertaken only through capital expenditures, not through borrowed funds, and only if there was a prolonged delay between proposal and AHAP.

HUD determined that Trafalgar's post-proposal, pre-AHAP costs could not be included in a return on investment request, despite its meeting the prolonged period element, because Trafalgar failed to meet the actual cash equity requirement. The $1.6 million was expended from borrowed funds, not owner capital. Trafalgar argues that differentiating between actual cash equity and financed funds for the purposes of return on investment is arbitrary and capricious.

In our view, limiting return on investment to capital expenditures is fully supportable. HUD recognizes that the larger costs, such as the cost of acquiring the property, could either be financed or paid out of owner capital, and has established a scheme to deal with each scenario. For financed costs, HUD allows the owner to be repaid the principal and interest through property debt service. For large costs paid from owner capital, HUD allows the owner to recoup the expenditure plus a reasonable "return on investment." In theory then, owners are repaid any borrowed costs through property debt service and any capital expenditures through return on investment.[6] Under this scheme, it is not arbitrary and

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[6]HUD has established a similar system for repaying rehabilitation costs. If rehabilitation is financed through borrowed funds, the principal and interest are included in rehabilitation debt service. If the owner has paid for

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capricious to restrict property debt service to outstanding indebtedness, and limit return on investment to actual cash equity.

The problem for Trafalgar is that it incurred rehabilitation expenses earlier than it should have. Had Trafalgar complied with HUD regulations and executed an AHAP before commencing rehabilitation, *see* 24 C.F.R. § 882.505 (1998), its costs would have been incorporated into rehabilitation debt service. Although the parties discussed the possibility of including pre-AHAP costs in base rent, the HUD Handbook, available to Trafalgar at the time, provides for return on investment only if the two conditions are met. HUD's ultimate decision to follow its Handbook in dealing with the situation once it understood that Trafalgar could not comply with both conditions was "reasoned and supported by substantial evidence in the record." *Associate Fisheries*, 127 F.3d at 109. In fact, a decision to allow Trafalgar to recover these costs, contrary to the regulations and the HUD Handbook, might have provoked criticism that HUD was acting arbitrarily and capriciously by inconsistently applying its own policies.

We therefore conclude that HUD appropriately denied Trafalgar's request to include the $1.6 million in base rent. HUD's regulations reasonably barred incorporating these costs in either the property debt service component or return on investment allowance, and the agency's decision to follow those regulations cannot be termed arbitrary or capricious. The district court's finding to the contrary must be reversed.

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[9](...continued)
rehabilitation out of owner capital, HUD pays the owner interest on those funds based on an imputed interest rate. HUD Handbook, pp. 7, 17.

B. *Whether HUD inappropriately refused to raise the contract rents after two errors were discovered.*

In the HAP, HUD made two errors in calculating the contract rent, one to Trafalgar's detriment and the other to its benefit. HUD refused to remedy the error that disadvantaged Trafalgar because this error was more than offset by the mistake to Trafalgar's benefit. The district court found HUD's decision to maintain the status quo arbitrary and capricious. We disagree.

On September 24, 1984, the public housing agency sponsoring the project requested an "exception rent," allowing for a 10 percent increase in the contract rent ceiling. Under the regulations, an exception rent is appropriate only when the rate otherwise applicable does not accurately reflect the rents being charged in the project's specific geographic area. *See* 24 C.F.R. § 882.408(b) (1998). HUD's Boston Regional Office initially denied the request, and Trafalgar appealed the denial to the Assistant Secretary for Housing. Before HUD headquarters had decided the appeal, however, the Regional Administrator reassessed the situation, reversed the earlier decision, and erroneously agreed to allow Trafalgar to charge an exception rent.[7] The very next day, HUD headquarters, unaware of the

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[7]Although the district court did not address the issue, the Regional Administrator's decision to grant an exception rent was erroneous for two reasons. First, exception rents are permitted if HUD has determined that the rents in the specified area "are more than 10 percent higher than the Existing Housing Fair Market Rents." 24 C.F.R. § 882.408(b) (1998). Use of the present tense in this regulation indicates that the rents must currently be above the FMR. The documentation supporting the Regional Administrator's grant did not analyze current rents in the area and compare them to the FMR. Instead, the documents show that the decision was made because the Regional Administrator predicted that property values and housing costs would increase significantly in the near future. (*See* App. at

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Regional Director's new decision, affirmed the earlier denial of an exception rent. Since the Regional Administrator had approved the request, the HAP included the erroneous exception rent, to Trafalgar's benefit.

The other error in the HAP stemmed from HUD's application of the wrong debt service constant, which had the effect of reducing the contract rent, thereby limiting how much Trafalgar could recoup from HUD. HUD has conceded it made this debt service error and that it negatively impacted Trafalgar's payment from HUD.

When the debt service error was discovered in 1992, Trafalgar requested a correction. As a result of this request, HUD was required to recalculate the contract rent, and, in the course of doing so, realized the error in allowing Trafalgar to charge an exception rent. HUD decided that the most appropriate course of action would be to correct all errors.

The exception rent error, accruing to Trafalgar's benefit, was greater than the debt service error, to its detriment.

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[7](...continued)

148).

Second, the operative language of the same regulation allows the public housing agency to approve exception rents "for *all units* of a given size *in specified areas*" where the local rents exceed the FMR. 24 C.F.R. § 882.408(b) (1998) (emphasis added). The HUD Handbook describes a specified area as "an entire locality, municipality or county with a Fair Market Rent area or for a specific neighborhood(s)." HUD Handbook, Ch. 10, 10-2 (c) (1), p. 10-1. The record indicates that the request was approved for this single project, and not for a specified area. (*See* App. at 149 (request for an exception rent "is approved for the subject project."); App. at 142 (requesting an exception rent "for a specific project, the Heywood-Wakefield Building")).

Trafalgar does not argue that the Regional Administrator's decision was correct, but rather that HUD is bound by that decision, correct or not.

Correction of both errors would therefore end up lowering, rather than raising, the contract rent, and would reduce the amounts Trafalgar would receive from HUD. An amendment to the Moderate Rehabilitation Program statute prohibits HUD from reducing the contract rents in effect on or after April 15, 1987, *see* 42 U.S.C. § 1437f(c)(2)(C), except when the property is refinanced and the owner's debt costs are decreased. Since the correction of both errors would have resulted in reducing the contract rent in violation of the statute, HUD chose to maintain the status quo with the two errors.

Upon cross-motions for summary judgment, the district court separated the two errors. Addressing the debt service mistake first, the court found that HUD was required to make a correction. In support of this decision, the court emphasized the language of paragraph 1.5 of the HAP, which states that contract rents "are subject to post-audit and change in accordance with HUD requirements, including the correction of errors in computation." *Trafalgar Capital Assoc., Inc. v. Cisneros*, 973 F. Supp. 214, 221 (D. Mass. 1997) (quoting HAP, ¶1.5). The district court found this mistake to be an error in computation that had to be corrected in accordance with that paragraph's mandate. *See id.* Having found that HUD was required to correct the debt service constant, the district court went on to consider the exception rent mistake. It determined that correcting that error would result in a reduction contrary to § 1437f(c)(2)(C)'s mandate. The net result of the district court's ruling left HUD correcting the debt service error, but Trafalgar continuing to benefit from the exception rent error.

HUD argues on appeal that it was entitled to offset the errors and that, because the net result would disadvantage Trafalgar, it could maintain the status quo in order to comply with the statutory prohibition against reducing the contract

rents.[8] Trafalgar argues that failure to correct the debt service error causes a *de facto* reduction because using the correct debt service constant would have produced a higher contract rent.

To determine whether HUD's decision to maintain the status quo was legitimate, we look to the anti-reduction provision of the statute. The "starting point for interpretation of a statute 'is the language of the statute itself.'" *Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 835 (1990) (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)); *see Arnold v. United Parcel Service, Inc.*, 136 F.3d 854, 857-58 (1st Cir. 1998). "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). If the statutory text and congressional intent are ambiguous, HUD's interpretation is entitled to deference if it is reasonable. *See id.* at 844-45.

The statute provides:

> The Secretary may not reduce the contract rents in effect on or after April 15, 1987, for newly constructed, substantially rehabilitated, or moderately rehabilitated projects assisted under this section

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[8]Although the district court decided to separate the costs from one another, it was acceptable for HUD to consider the errors jointly, as it did. Paragraph 1.5(a) of the HAP gives HUD the authority to "change [the contract rent] in accordance with HUD requirements, including the correction of errors in computation." (App. at 31). An argument could be made that the time for recalculation pursuant to ¶ 1.5 had expired. If so, Trafalgar's claim would be moot since the current contract rents would continue to apply. Assuming that time had not foreclosed any challenge, both mistakes were found and "change[d] in accordance with HUD requirements." (*Id.*)

> (including projects assisted under this section as in effect prior to November 30, 1983), unless the project has been refinanced in a manner that reduces the periodic payments of the owner.

42 U.S.C. § 1437f(c)(2)(C). We first must determine what contract rent was "in effect," and then must assess whether HUD's decision to maintain the error-riddled status quo reduced that rent in violation of the statute.

1. *Contract Rent In Effect*. The only contract rent used by the parties is the erroneous rent set in the HAP in 1990. Trafalgar argues that that contract rent was not "in effect" within the meaning of the statute, because the regulations require HUD to raise the contract rent to correct the debt service error. Trafalgar maintains that, therefore, "by law, the increased 'contract rents' were 'in effect' and HUD's refusal to raise the [contract rents accordingly] constituted a *de facto* reduction . . . in violation of 42 U.S.C.A. § 1437f(c)(2)(C)." (Brief for appellee/cross-appellant, p. 25).

The regulation on which Trafalgar relies provides that the "initial Contract Rents . . . will be the Contract Rents on the effective date of the [HAP] except . . . [w]hen necessary to correct errors in computation of the base and Contract Rents to comply with the HUD requirements." 24 C.F.R. § 882.408(d)(1) (1998). Trafalgar invokes this language to correct one error, but not the other. If this regulation required the agency "to correct errors in computation. . . to comply with the HUD requirements,"[9] HUD would have to correct both

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[9]It is not clear whether the regulation can even be applied at this late date. The title of this subsection is "Changes in Initial Contract Rents during rehabilitation." 24 C.F.R. § 882.408(d) (1998). Two sister circuits have held that the regulation authorizes only changes that occur prior to the

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errors. Such an argument undermines Trafalgar's position because the contract rent "in effect" would contain neither error. The end result of this argument is that the contract rent "in effect" would be lower than that under which the parties have been operating. It is therefore to Trafalgar's advantage that we view the contract rent "in effect" to be the rent under which the parties have been operating. Because HUD does not dispute this construction of the language, we accept it as governing here.

2. *Reduction of the Contract Rent.* Having identified the rent "in effect" as the status quo, we easily can dispose of the contention that HUD violated § 1437f(c)(2)(C) by reducing the contract rent in effect. The contract rent in effect has been neither reduced nor increased. The plain language barring reductions does not require HUD to *raise* the contract rent in this situation. "[I]t is *reductions* in rent that are expressly proscribed by section [1437f] (c)(2)(C)." *Foxglenn*, 35 F.3d at 950 (emphasis added). HUD's decision to keep the current contract rents complied with the statute's plain language, and consequently cannot be considered arbitrary and capricious. The district court's decision to the contrary must be reversed.

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[9](...continued)
end of rehabilitation. *See Foxglenn Investors L.P. v. Cisneros*, 35 F.3d 947, 953 (4th Cir. 1994) ("This regulation clearly addresses HUD's authority to change contract rents during rehabilitation. Since the reductions in this case occurred well after rehabilitation, this regulation would appear to be inapplicable."); *Terrace Hous. Assoc., Ltd. v. Cisneros*, 32 F.3d 461, 464 (10th Cir. 1994) ("It is clear that [§ 882.408(d)(1)] does not apply here because rehabilitation was completed long ago."). However, since the regulation is unavailing to Trafalgar even if it were applicable, the court need not address whether it applies.

C. *Whether HUD inappropriately classified the SHARP funds as grants.*

In 1985 and 1987, Trafalgar entered into contracts to receive more than $1 million over 15 years from the Massachusetts SHARP program. In determining how the receipt of those funds impacted Trafalgar's contract with HUD, HUD was required to classify them as either a grant or a loan. If the SHARP funds were grants, the HUD regulations would require Trafalgar to subtract the amount from the debt service calculations, and it therefore would not be included in the base rent. If the SHARP funds were loans, the amounts would have been included in the debt service calculation for the purposes of computing the base rents.

The SHARP contracts have many of the indicia of loans. Indeed, the SHARP program's enabling legislation provides that the financial assistance shall be "in the form of a loan." Mass. Gen. Laws ch. 23B, § 27. The Massachusetts Department of Housing and Community Development ("DCHD") is empowered to determine the appropriate annual amount of the "loan proceeds" to be distributed to each project. *Id.* One of the restrictions on the DCHD's authority is that the disbursement decisions must be "consistent with the repayment of the loan as hereinafter provided." *Id.* The repayment obligations may not be waived in whole or in part. *See id.* To guarantee that the loans are actually repaid, they are secured by a lien on real or personal property, or both. *See id.*

The contracts executed by Trafalgar and the Massachusetts Housing Finance Agency ("MHFA"), the body overseeing the SHARP program financing obligations, confirm these details. The contracts provide that Trafalgar would receive "housing subsidy loans" under the SHARP Program. (App. at 50). Paragraph 12 of the contracts contains language highly relevant to the decision to classify SHARP proceeds as a grant or loan:

> The parties specifically understand and agree that the SHARP funds provided by this Contract are considered to be a loan from the [Executive Office of Communities and Development ("EOCD")] to the [MHFA] and not a grant of money. The loan provided hereunder shall be evidenced by a Subsidy Repayment Note. . . . This Subsidy Repayment Note shall be, and hereby is, secured by the mortgage on the Project.

(App. at 55, 68). Three statements in this paragraph are relevant: 1) the parties acknowledged that this money was a loan "and not a grant" from EOCD to MHFA, who then loaned it to Trafalgar; 2) the loan was evidenced by a repayment note; and 3) the repayment obligation was secured by a mortgage.

The attached "Subsidy Repayment Notes" stated that Trafalgar would repay the MHFA the principal amount of the notes, "together with simple interest thereon." (App. at 60, 74). Trafalgar was obliged to repay the principal and interest on December 1, 2016, unless Trafalgar had defaulted on the loans or sold the project prior to that date. While the notes were expressly secondary to any existing mortgage on the property, Trafalgar agreed to use any assets remaining after repaying the mortgage to repay the notes, and agreed "to pay, in addition to other amounts due, all reasonable legal charges and expenses incurred for collecting the debt, including attorney's fees." (App. at 61, 75).

Despite these indicators suggesting that the SHARP funds were loans, HUD decided to classify them as grants for two reasons. First, HUD stated that the repayment obligations were not sufficiently imminent because Trafalgar was not required to repay any of the loan proceeds until December 1, 2016. HUD took the position that base rents should not reflect costs that will not come due during the term of the HAP; the HAP expired in the year 2002, fourteen years before the loan's due

date. Second, HUD stated that the SHARP obligations were not sufficiently certain to justify inclusion in the base rents. Under the SHARP contracts, Trafalgar's obligation to repay the principal and interest might be altered. Trafalgar could "recycle" the principal into the project by, for instance, providing the tenants with rent subsidies or a credit toward the purchase of project units. Interest payments could be forgiven if Trafalgar instituted a program to limit the impact of the SHARP program termination on the low and moderate income tenants. Because the principal could be recycled and the interest forgiven, HUD found that the repayment obligations were too uncertain to justify treatment as a loan and inclusion in the contract rents.

At first blush, these reasons seem rational, and perhaps sufficient to survive review under the deferential arbitrary and capricious standard. However, neither basis for HUD's decision makes rational sense to this court, as the arbitrary and capricious standard requires.

1. *Costs due after HAP termination.* As stated earlier, the base rent is designed to represent the cost of owning, managing and maintaining the unit. In this case some of those costs have been advanced by a third party. The fact that Trafalgar's repayment obligations do not mature until after the conclusion of the HAP contract does not mean that the principal and interest payments are not costs of owning, managing and maintaining the unit. HUD's argument could be used to exclude other significant costs. For instance, Trafalgar might have purchased the property by a mortgage with a single balloon payment due after the HAP term. In such a situation, HUD's argument would bar consideration of the mortgage obligation, even though it clearly represents a cost of owning, managing and maintaining the property. As the district court stated, the fact that Trafalgar's repayment obligation accrues

well after the conclusion of the HAP term does not mean that Trafalgar has "received a gift . . . and not a loan." *Trafalgar Capital Assoc.*, 973 F. Supp. at 220.

HUD has recognized that the rehabilitation debt service may include amounts to be paid by the project owner after the conclusion of the HAP, specifically payment of a rehabilitation loan whose term might extend beyond the 15-year HAP period. (*See* HUD Handbook, p. 17 (the proposal might include "a loan term longer than 15 years (e.g. 30 years if a 30-year loan is obtained)"). The agency does not exclude the rehabilitation costs being paid by such a loan even though some principal might not be repaid until years after the HAP has terminated. We see no basis for excluding from base rent costs that are similarly financed in a long range manner. A balloon payment of principal and interest strikes us as materially equivalent to the extended loan payments that HUD routinely views as appropriate costs. HUD's argument that the SHARP funds are a grant because they are repaid after HAP termination is thus inconsistent with its other practices and, as a result, unconvincing.

2. *Costs not sufficiently certain*. The second reason HUD gives for classification of the SHARP funds as a grant is the possibility that the principal might be "recycled" into the project, and the interest might be forgiven. This rationale is equally unavailing.

Under the SHARP statute, Trafalgar is required to submit a proposal to Massachusetts to limit the impact of SHARP assistance termination on low and moderate income tenants. As noted earlier, such a proposal might involve using the SHARP principal to subsidize the tenants' rents, or it might feature a credit to the tenants toward the purchase of their unit. Whatever the form of the proposal, Trafalgar's receipts would be less than they otherwise would have been. Instead of paying the

principal to MHFA, Trafalgar effectively would be paying that amount to the tenants.

The direct recipient of Trafalgar's "repayment" is immaterial for determining whether the SHARP funds are a grant or a loan; if "recycling" occurs, Trafalgar suffers the same financial loss as it would in repaying the loan directly to the MHFA. The district court was correct when it stated that "[i]t is entirely unreasonable to suggest that, because the eventual recipients of [Trafalgar's] repayment are the tenants, . . . [Trafalgar] is not, in reality, paying back the loan's principal." *Trafalgar Capital Assoc.*, 973 F. Supp. at 220.

The fact that interest might be forgiven also does not automatically mean that the SHARP funds become a grant rather than a loan. As HUD well knows, any decision to reduce or waive the interest is in the sole and exclusive discretion of MHFA, and "will only be allowed if [Trafalgar] produces an *exceptional* plan for helping low and moderate income families" transition from receiving SHARP financial assistance to the termination of the SHARP program. (App. at 228) (emphasis added). Any future decision by MHFA to waive the interest does not alter Trafalgar's current obligation to pay interest on the principal it has received. In addition, even if interest on the SHARP funds is waived in part or in whole, the SHARP assistance would constitute either a low-interest or interest-free loan, both of which are still loans. (*See id.*) If the principal still must be repaid, the reduction or elimination of interest does not convert a loan to a grant.

In sum, then, it was not rational for HUD to classify the SHARP funds as a grant rather than a loan. The SHARP contracts have all the indicia of loans. They require repayment of the principal and interest. They are secured by a lien on the property. If Trafalgar does not fulfill its obligations, it agreed to pay all legal costs, including attorney's fees, associated with

collection efforts. And the language in the contracts explicitly states that they are loans and not grants.[10] HUD's reasons for classifying them as grants are not reasonable. The expense of repaying the SHARP funds, although incurred after HAP termination, is a cost of owning, managing and maintaining the property. Interest is forgiven only under the state's discretion, and, even if it were forgiven, an interest-free loan is still a loan. We therefore affirm the district court's ruling that HUD's decision to classify the SHARP funds as a grant was arbitrary and capricious.[11]

D. *Whether the statute of limitations bars Trafalgar's claim that the 1986 FMR should have been used.*

The Fair Market Rent, or FMR, used in the AHAP and HAP establishes the ceiling for the contract rents and therefore has a significant impact on an owner's subsidy from HUD. Trafalgar argues that HUD improperly used the 1985 FMR instead of the higher 1986 FMR, thereby reducing the funds to which Trafalgar was entitled. The district court found this claim to be barred by the statute of limitations, and Trafalgar challenges this decision on cross-appeal. Application of the

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[10]In reaching this conclusion, we are not saying that the language in the legislation and the contracts is necessarily always controlling. However, nothing in this case indicates that the language is inconsistent with reality.

[11]We note that our conclusion is influenced by the fact that HUD admittedly has no rules or procedures for determining whether funds are loans or grants. It is precisely this sort of ad-hoc standardless determination that is likely to be arbitrary and capricious under the Administrative Procedure Act. *See Morton v. Ruiz*, 415 U.S. 199, 232 (1974) ("The Administrative Procedure Act was adopted to provide, inter alia, that administrative policies affecting individual rights and obligations be promulgated pursuant to certain stated procedures so as to avoid the inherently arbitrary nature of unpublished ad hoc determinations.").

statute of limitations by definition involves an appreciation of the dates involved, so our analysis must start there.

The FMR is based on the rents actually charged for units in the same area, and the Secretary of HUD is required to establish FMRs "periodically but not less than annually." 42 U.S.C. § 1437f(c)(1). On July 5, 1984, HUD first published the 1985 FMRs as an interim rule with an effective date of October 1, 1984. The 1985 FMRs were published in final rule form on April 16, 1985.

The AHAP was executed on April 30, 1986. In accordance with the regulations, it specified that the initial contract rents would be based on the FMRs then in effect, which were the 1985 rates. The 1986 FMR applicable to the project was published and made effective on August 29, 1986, four months after AHAP execution, and twenty-two months after the 1985 FMR had gone into effect.

On April 17, 1990, the parties executed the final stage of the HAP contract. Trafalgar argued that the base and contract rent ceilings should be based on the 1986 FMR, but HUD insisted on using the 1985 rate. Trafalgar chose to pursue administrative remedies, which were exhausted with HUD's final denial on April 7, 1995.

Trafalgar filed its claim in the district court on June 15, 1995. It argued that, consistent with the statutory requirement, the 1986 FMRs should have been established by October 1, 1985, one year after the 1985 FMRs went into effect. Had HUD followed the statutory mandate to set the FMRs no less than annually, the AHAP and HAP would have used the 1986 FMRs.

A complaint under the APA for review of an agency action is a civil action that must be filed within the six year limitations period set forth in 28 U.S.C. § 2401(a). *See, e.g., Daingerfield*

Island Protective Society v. Babbitt, 40 F.3d 442, 445 (D.C. Cir. 1994); *Wind River Mining Corp. v. United States*, 946 F.2d 710, 712 (9th Cir. 1990). The only two relevant actions within six years of the June 15, 1995 filing of the complaint are the HAP execution on April 17, 1990, and the conclusion of administrative appeals on April 7, 1995. Appreciating this fact, Trafalgar argues that the claim did not accrue either until the HAP was executed or until Trafalgar had exhausted its administrative remedies. In its decision that Trafalgar's claim was barred by the statute of limitations, the district court implicitly rejected Trafalgar's first argument, and explicitly rejected the second.

1. *HAP execution.* In general, "[a] cause of action against an administrative agency 'first accrues,' within the meaning of § 2401(a), as soon as . . . the person challenging the agency action can institute and maintain a suit in court." *Spannus v. DOJ*, 824 F.2d 52, 56 (D.C. Cir. 1987). Under the APA, the injured party can maintain a suit once the agency has issued a "final agency action." 5 U.S.C. § 704; *see, e.g.*, *Sierra Club v. Slater*, 120 F.3d 623, 631 (6th Cir. 1997); *Dunn-McCampbell Royalty Interest, Inc. v. National Park Serv.*, 112 F.3d 1283, 1287 (5th Cir. 1997). In determining whether a particular agency action is final, "[t]he core question is whether the agency has completed its decisionmaking process, and whether the result of that process is one that will directly affect the parties." *Franklin v. Massachusetts*, 505 U.S. 788, 797 (1992). To be a "final agency action," it must be a "definitive statement[ ] of [the agency's] position" with "direct and immediate" consequences. *FTC v. Standard Oil Co.*, 449 U.S. 232, 241 (1980).

Determining which HUD statement was the final agency action is a relatively straightforward exercise. HUD regulations require that initial rents are capped at the FMR "applicable to

the unit on the date that the [AHAP] is executed." 24 C.F.R. § 882.408(c) (1998). This limit applies to both the AHAP and HAP, even though payments do not commence until rehabilitation has been completed and the parties have executed the HAP, which may be well after the date of the AHAP. Therefore, the final agency action for the purpose of commencing the statute of limitations was the final statement by HUD setting the FMR that applied on the date of AHAP execution.

The 1985 FMR was in effect at the time of AHAP execution on April 30, 1986. Although HUD should have promulgated the 1986 FMRs by that time, HUD followed the regulation requirement to apply the FMR then in effect. A strong argument can be made that AHAP execution was the final agency action for the purpose of commencing the statute of limitations.[12]

However, one could also argue that the final agency action did not occur until HUD actually issued the 1986 FMR on August 29, 1986. On that date, at the latest, Trafalgar learned that HUD would not apply the new rate to its previously executed AHAP. Prior to that date, Trafalgar had a possible argument that the 1986 FMR, which reflected rates as of April

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[12]This conclusion is bolstered by the fact that Trafalgar was on notice that the AHAP would use the 1985 FMR and HUD would not countenance a request by Trafalgar to use the 1986 FMR in the AHAP or HAP. A section of the February 12 EOCD letter summarizing the February 5 meeting addresses the issue of possible revisions to the FMRs from the 1985 levels then in effect. Specifically, Trafalgar was on notice that "[n]either EOCD nor HUD will allow any re-computation of rents for this project to occur if and when the FMRs are reissued." (App. at 152).

1, could be applied retroactively to the AHAP executed April 30.[13]

Deciding which of these decisions was the final agency action is unnecessary, because both occurred well outside the statute of limitations. Even if the issuance of the 1986 FMR were the final agency action, rather than AHAP execution, Trafalgar would have been required to file its action in court before August 29, 1992, six years later. Trafalgar's complaint was not filed until June 15, 1995, almost three years after the expiration of the statute of limitations.

Trafalgar argues that the HAP was the final agency decision because HUD could change the terms of the contract between the AHAP and HAP. The relevant regulation allows HUD to change the contract rent between the AHAP and HAP under certain limited circumstances: unexpected changes in rehabilitation costs, changes in financing, changes in relocation payments to tenants, or to correct errors in computation. *See* 24 C.F.R. § 882.408(d)(1) (1998). None of these situations applies. Moreover, the regulations specifically require application of the FMR applicable on the date of the execution of the AHAP. HUD's issuance of the 1986 FMR was therefore the final agency action with respect to Trafalgar's claim.[14]

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[13]It should be noted that the statute would seem to preclude retroactive application of the FMR, because the FMR "shall become effective upon the date of publication in final form in the Federal Register." 42 U.S.C. § 1437f(c)(1).

[14]Trafalgar also argues in its reply brief that the HAP could have included the 1986 FMR because HUD had the power to waive "any provision" of the regulatory scheme for good cause, subject to statutory limitations. *See* 24 C.F.R. § 899.101(a) (1995). However, Trafalgar failed to make this argument before the district court. As a result, the argument has been waived. *See Timberland Design v. First Serv. Bank for Sav.*, 932

(continued...)

2. *Exhaustion of administrative remedies*. In the alternative, Trafalgar alleges that the cause of action did not accrue until it had exhausted all available administrative remedies. The district court rejected this argument, ruling that Trafalgar's decision to pursue administrative remedies not explicitly a prerequisite to suit did not affect the accrual of its claim.

The Supreme Court has held that "no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938). "In practice, the doctrine has softer edges than this language implies." *Portela-Gonzalez v. Secretary of the Navy*, 109 F.3d 74, 77 (1st Cir. 1997). When Congress explicitly requires that administrative remedies must be pursued before seeking judicial relief, litigants must obviously follow that mandate. *See Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561, 579 (1989). On the other hand, "where Congress has not clearly required exhaustion, sound judicial discretion governs." *McCarthy v. Madigan*, 503 U.S. 140, 144 (1992).

While most of the decisions regarding administrative remedies involve whether the litigant has filed suit too early, *i.e.*, before exhaustion of administrative remedies, this case involves the opposite question. We must consider whether or when a party that does pursue administrative remedies before filing suit is barred for untimeliness.

In this latter event, it makes a difference whether the administrative route is mandatory, *i.e.*, a condition precedent to suit, or permissive, *i.e.*, permitted but not required as a

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[14](...continued)
F.2d 46, 51 (1st Cir. 1991) ("It is clearly established that arguments not raised at the district court level will not be considered on appeal.").

condition precedent. In the former situation, the cause of action does not accrue until the completion of the required administrative proceedings. *See Crown Coat Front Co. v. United States*, 386 U.S. 503, 522 (1967); *United States v. Suntip Co.*, 82 F.3d 1468, 1475 (9th Cir. 1996); *United States v. Gordon*, 78 F.3d 781, 786 (2d Cir. 1996). In the latter situation, the cause of action accrues at the time of the injury. *See Unexcelled Chemical Corp. v. United States*, 345 U.S. 59, 65 (1953); *Brighton Village Assoc. v. United States*, 52 F.3d 1056, 1060 (Fed. Cir. 1995).[15] Trafalgar has throughout its briefings consistently ignored this contrast, which we specifically recognized in *United States v. Meyer*, 808 F.2d 912 (1st Cir. 1987).

The district court correctly recognized this distinction in holding that Trafalgar's claim accrued before it began to seek permissive administrative remedies.[16] Trafalgar was entitled to pursue administrative remedies, but its choice to do so did not stop the statute of limitations from running.[17]

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[15]Consistent with this, if a claim arises under the APA, courts may not exercise their judicial discretion to require exhaustion of administrative remedies if the statute and agency rules do not otherwise require exhaustion. *See Darby v. Cisneros*, 509 U.S. 137, 153-54 (1993). However, if the statute at issue explicitly mandates exhaustion as a prerequisite to judicial review, it must be enforced. *See id.*

[16]It is not clear from Trafalgar's briefs whether it concedes that the administrative remedies were permissive. Nevertheless, the permissive nature of the remedies is clear to the court: nothing required that they be pursued. No formal administrative remedies were required or even provided for in the statute. HUD has not adopted any agency rule that Trafalgar may not file a complaint until after it has exhausted administrative remedies.

[17]Because the court finds that Trafalgar's claim regarding the application of the 1986 FMR was time barred, it is unnecessary to reach

(continued...)

III. *Conclusion*

We reverse the district court's determination that HUD acted in an arbitrary and capricious manner in excluding the pre-AHAP costs from the base rents and in maintaining the status quo when offsetting mistakes were made. The district court, however, correctly concluded that HUD was arbitrary and capricious in treating the SHARP funds as a grant instead of a loan. Trafalgar's claim to use a different year FMR was time-barred, as the district court appropriately found.

Accordingly, the district court's judgment is affirmed in part and reversed in part. HUD to receive half its costs.

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[17](...continued)
Trafalgar's allegation that HUD was required to disclose a certain document during discovery on that claim.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 97-2152

TRAFALGAR CAPITAL ASSOCIATES, INC., ETC.

Plaintiff-Appellee,

v.

ANDREW CUOMO, ETC.,

Defendant-Appellant,

EXECUTIVE OFFICE OF COMMUNITIES
AND DEVELOPMENT, ET AL.,

Defendants-Appellees.

No. 97-2153

TRAFALGAR CAPITAL ASSOCIATES, INC., ETC.,

Plaintiff-Appellant,

v.

ANDREW CUOMO, ETC., ET AL.,

Defendant-Appellees.

JUDGMENT

Entered: October 29, 1998

These causes come on to be heard on appeals from the United States District Court for the District of Massachusetts, and were argued by counsel.

Upon consideration of whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the district

court is affirmed in part and reversed in part in accordance with the opinion filed this day.

HUD to receive half its costs.

[Half costs in favor of HUD are taxed at nothing, $0.00]

BY THE COURT:

Phoebe Morse, Clerk.

By /s/ Janice M. O'Neil
Chief Deputy Clerk.

cc: Ms. Simon
Mr. Coan

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

CA-No. 95-11267-JLT

TRAFALGAR CAPITAL ASSOCIATES, INC.,
in its capacity as Managing General Partner of
HEYWOOD-WAKEFIELD ASSOCIATES LIMITED PARTNERSHIP,
Plaintiff,

v.

HENRY C. CISNEROS,
in his capacity as Secretary of United States
Department of Housing and Urban Development,
EXECUTIVE OFFICE OF COMMUNITIES AND DEVELOPMENT,
and RURAL HOUSING IMPROVEMENT, INC.,
Defendants.

Alan M. Spiro, Friedman & Atherton, Boston, MA, Carl A. Coan, Coan & Lyons, Washington, DC, for Trafalgar Capital Associates.

Susan M. Poswistilo, U.S. Atty.'s Office, Boston, MA,for Henry G. Cisneros.

Loretta M. Smith, Atty. Gen's Office, Boston, MA, for Executive Office of Communities and Development.

MEMORANDUM

July 16, 1997

TAURO, Ch.J.

Plaintiff, Trafalgar Capital Associates, Inc. ("Trafalgar"), is a general partner of the Heywood-Wakefield Associates

Limited Partnership ("HWLP"). HWLP owns a multi-family rental housing project (the "Project") in Gardner, Massachusetts.

Trafalgar contends that the United States Department of Housing and Urban Development ("HUD") improperly calculated the rents HWLP is entitled to charge tenants of the Project. Trafalgar, in its complaint, seeks mandamus and declaratory relief, in order to force HUD to allow higher rents.

Presently before the court are the parties' cross-motions for summary judgment.

I. *THE SECTION 8 MODERATE REHABILITATION PROGRAM*

Congress passed the Section 8 Moderate Rehabilitation Program of the United States Housing Act of 1937 (the "MRP") with the intention of "aiding low-income families in obtaining a decent place to live and of promoting economically mixed housing." 42 U.S.C. § 1437f(a). The MRP creates a procedure by which HUD can subsidize a portion of the rents tenants pay for low-income housing.

Under the MRP, HUD enters into an annual assistance contract with a public housing agency ("PHA"). The PHA then enters into an Agreement to enter into a Housing Assistance Payments contract ("AHAP") with a housing project owner. The AHAP sets forth an estimate of both the base rent and contract rent for the project. The base rent is either the rent for a unit before rehabilitation, or the cost to the owner of owning, managing, and maintaining the unit after rehabilitation. The contract rent is calculated by adding the monthly cost of financing the rehabilitation and, perhaps, an allowance for the rehabilitation costs not covered by debt to the base rent. The

owner will receive, from HUD, through the PHA, the difference between the contract rent and the rent that the tenants are required to pay. Normally, the owner will not begin rehabilitation of the housing project prior to the execution of the AHAP.

After the project is fully rehabilitated, pursuant to certain conditions established in the AHAP, the PHA and the owner will sign a Housing Assistance Payments contract ("HAP"), which sets forth the final base and contract rents. The rents set out in the HAP will mirror the AHAP rents unless they are adjusted pursuant to provisions of the AHAP contract, the HAP contract itself, or HUD regulations.

II. *THE HEYWOOD-WAKEFIELD PROJECT*

On April 13, 1984, Defendant Executive Office of Communities and Development ("EOCD"), a PHA, applied to HUD for funds pursuant to the MRP. HUD approved the application on September 28, 1984.

EOCD and HUD entered into an Annual Contributions Contract ("ACC") on April 3, 1985. The ACC permitted the use of exception rents[1] at 132% of the Existing Housing Fair Market Rents. This provision was based upon the decision of the Regional Administrator of HUD's Boston Regional Office to allow the exception rents.

On October 11, 1985, HWLP borrowed over $ 10 million from the Massachusetts Housing Finance Agency ("MHFA") for the purpose of rehabilitating the Project. It borrowed over

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[1]A HUD Field Office may grant exception rents up to a certain level pursuant to HUD Handbook 7420.3 if "special circumstances" warrant doing so.

$3 million more on May 12, 1986. Contrary to the normal practice, HWLP began the rehabilitation of the Project prior to the execution of the AHAP.

In addition to the MHFA loans, HWLP will receive a total of over $1 million over fifteen years pursuant to the State Housing Assistance for Rental Production ("SHARP") contracts it entered into with the MHFA and EOCD. HWLP executed the SHARP contracts in September 1985 and November 1987.

On April 30, 1986, HWLP signed an AHAP for the purposes of rehabilitating the Project and receiving funds pursuant to the MRP. EOCD and Defendant Rural Housing Improvement, Inc. ("RHI") executed the AHAP on May 6, 1986. The initial base and contract rents for the Project were included in the AHAP.

The rehabilitation of the Project was completed in four separate stages. After each stage, an HAP was executed with regards to the finished rental units. The final stage was completed, and the final HAP executed, on April 17, 1990.

III. *THE COMPLAINT*

On June 15, 1995, Trafalgar filed its complaint. It complains of five separate actions of HUD. It argues that HUD: (1) used improper Fair Market Rents ("FMRs") for the Project; (2) improperly classified the SHARP funds as a grant, rather than a loan; (3) did not fully recognize all of the eligible costs incurred by HWLP during the rehabilitation of the Project; (4) used an incorrect debt-service constant on the MHFA loan; and, (5) unlawfully reversed the Boston Regional Administrator's grant of exception rents.

IV. *FAIR MARKET RENTS*

A. Accrual

The maximum rents a property owner may charge under the MRP "shall not exceed by more than 10 per centum the fair market rental established by the Secretary [of HUD] periodically but not less than annually . . . ." 42 U.S.C. § 1437(c)(1). HUD regulations require that the FMRs applicable to a project are the FMRs in effect on the date of the AHAP's execution. 24 C.F.R. § 882.408(c). HUD's decision to use the Fiscal Year 1985 FMRs ("FY 19* * FMRs") was based upon its understanding that the AHAP applicable to the Project had an effective date of February 8, 1986, and the FY 1986 FMRs were not in effect until, at the earliest, April 22, 1986.[2]

HUD contends that Trafalgar's claim that HUD improperly used the FY 1985 FMRs, instead of the FY 1986 FMRs, is time-barred by the statute of limitations. It argues that Trafalgar's right of action accrued, for that issue, at the latest, when HUD adopted the FY 1986 FMRs for Gardner, Massachusetts, on August 29, 1986. On that date, HUD claims, Trafalgar knew that the rents for the Project were not going to be calculated using the FY 1986 FMRs. It argues, therefore, that Trafalgar could have brought this lawsuit as of that date.

Trafalgar responds that its right of action accrued when it had exhausted all available administrative remedies. Trafalgar argues that HUD's final decision in this case was not rendered until April 7, 1995. Trafalgar's right of action would, therefore, not have accrued until that date.

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[2] April 22, 1986 was the effective date for the FY 1986 FMRs for most of the country. The FY 1986 FMRs for Gardner, Massachusetts were not final until August 29, 1986.

It is settled that only after "a mandatory administrative decision occurs '[does a plaintiff's] claim or right to bring a civil action against the United States mature[] and . . . [the plaintiff] has the right to demand payment.'" *United States v. Meyer*, 808 F.2d 912, 917 (1st Cir.1987) (quoting *Crown Coat Front Co. v. United States*, 386 U.S. 503 (1967)). In other words, a plaintiff's cause of action accrues only after he has completed all mandatory administrative remedies.

The First Circuit has not ruled explicitly on the question of whether a plaintiff must exhaust all permissive administrative remedies before his cause of action against the United States accrues. *Meyer*, however, is instructive. The *Meyer* court held that the five-year statute of limitations for enforcement of a penalty under the Export Administration Act ran from the date the Department of Commerce imposed the penalty, not from the date of the underlying violation. *Meyer*, 808 F.2d at 922. The Defendant in *Meyer* cited the case of *Unexcelled Chemical Corp. v. United States*, 345 U.S. 59 (1953), to bolster his argument that the Government's claim had violated the statute of limitations. The court was not persuaded.

Important to the case before this court, the court in *Meyer* distinguished *Unexcelled*. In *Unexcelled*, the government could file a complaint without going through any administrative proceedings, *if it so* chose, whereas, in *Meyer*, the plaintiff had to undertake certain mandatory administrative procedures. The *Unexcelled* Court held that the cause of action accrued at the time of violation, not at the end of the permissive administrative actions. Id. at 66. In fact, the Supreme Court itself distinguished *Unexcelled* for that reason in *Crown Coat. Crown Coat*, 386 U.S. at 519.

Trafalgar cites *Constant v. United States*, 16 Cl.Ct. 629, *aff'd*, 884 F.2d 1398 (Fed. Cir.), *cert. denied*, 493 U.S. 1002 (1989), and *Adler v. United States*, 134 Ct.Cl. 200 (1956) for its

proposition that the right of action accrued only after all administrative action was completed. Both cases, however, relate to the issue of exhaustion of remedies, not to the issue of when a right of action accrues.

This court finds, therefore, that Trafalgar's claim accrued before it began to seek permissive administrative remedies, at the latest, on August 29, 1986, when it became aware that HUD would not use the FY 1986 FMRs to calculate the Project's rents.

B. Tolling

Before 1990, courts traditionally would not apply equitable principles to the tolling of statutes of limitations in cases against the United States. *Oropallo v. United States*, 994 F.2d 25, 28 (1st Cir.1993), *cert. denied*, 510 U.S. 1050 (1994). The Supreme Court changed that practice with its holding in *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990). In *Irwin*, the Court held that "the same rebuttable presumption of equitable tolling applicable to suits against private defendants should also apply to suits against the United States." *Id.* at 95-96. Still, according to the First Circuit, "[i]t is axiomatic that 'the grounds for tolling statutes of limitations are more limited in suits against the government . . . .'" *Kelley v. National Labor Relations Board*, 79 F.3d 1238, 1248 (1st Cir.1996) (quoting *Swietlik v. United States*, 779 F.2d 1306, 1311 (7th Cir.1985)). Trafalgar claims that the statute of limitations should be tolled for the period of time it was pursuing non-mandatory administrative remedies.

The weight of authority is against tolling in this situation. Courts have generally adopted the rule that the pursuit of permissive administrative remedies does not necessarily toll the statute of limitations. *See, e.g., Brighton Village Associates v. United States*, 52 F.3d 1056, 1060 (Fed.Cir.1995). *See also*

Cowhig v. Marsh, 693 F.2d 234, 235 (1st Cir.1982), *cert. denied*, 460 U.S. 1092 (1983).

The First Circuit noted in *Kelley* that equitable tolling "is 'appropriate only when the circumstances that cause a plaintiff to miss a filing deadline are out of his [or her] hands.'" *Kelley*, 79 F.3d at 1248 (quoting *Heideman v. PFL, Inc.*, 904 F.2d 1262, 1266 (8th Cir.1990), *cert. denied*, 498 U.S. 1026 (1991)). The court recognized a five-factor balancing test in deciding whether to equitably toll a statute of limitations. *Id.* at 1248. The five factors are: "(1) lack of actual notice of the filing requirement; (2) lack of constructive knowledge of the filing requirement; (3) diligence in pursuing one's rights; (4) absence of prejudice to the defendant; and (5) a plaintiff's reasonableness in remaining ignorant of the notice requirement." *Id.* Furthermore, the court found that "[c]ases in which the equitable tolling doctrine is invoked are most often characterized by some affirmative misconduct by the party against whom it is employed, such as an employer or an administrative agency." *Id.*

Here, Trafalgar does not argue that HUD ever acted improperly during negotiations, nor that there existed circumstances beyond Trafalgar's own control that prevented it from filing earlier. Trafalgar could have filed at any time after it was aware of the use of the FY 1985 FMRs. It chose not to.

Brighton Village is squarely on point. In 1991, an owner of Section 8 subsidized housing in Brighton, Massachusetts filed a compiaint alleging breach of contract because HUD failed to raise the contract rents from 1981-1986. *Brighton Village*, 52 F.3d at 1057. The Federal Circuit affirmed the decision of the District Court, dismissing the claims regarding the years 1981 through 1984. *Id.* at 1061.

The court found no reason to toll the statute of limitations. Id. at 1060-61. It held that "Brighton's pursuit of administrative remedies did not interfere with its ability to satisfy the statute of limitations." *Id.* at 1060. Brighton, for example, could have filed a protective action and then moved for a stay of the proceedings. *Id.* Also, the court found that "Brighton did not toll the limitations period by negotiating with HUD." *Id.* at 1061.

The one distinction between *Brighton Village* and the case before this court is that Trafalgar was quite diligent in pursuing administrative remedies, whereas Brighton was not. *Id.* To allow this difference to be determinative, however, would undercut the general rule that tolling does not occur during the pursuit of permissive administrative remedies. Any plaintiff, merely by seeking such remedies quickly, would be able to toll the statute.

This court holds that the statute of limitations did not toll, and, therefore, Trafalgar's claim that HUD used the improper FMRs is time-barred.

V. *SHARP FUNDS*

A. Statute of Limitations

HUD claims that the right of action as to the issue of whether it correctly characterized the SHARP funds as a grant rather than a loan accrued on April 30, 1986, the date the AHAP was executed. It is on that date, HUD contends, that Trafalgar was aware that HUD would not characterize the funds as a loan and could have brought its lawsuit. The right of action, therefore, would be barred by the six-year statute of limitations.

Trafalgar argues that the right of action did not accrue until April 17, 1990, the date the HAP was executed. Trafalgar's claim is that, until the execution of the HAP, the base rents could have changed upward or downward pursuant to the AHAP. Trafalgar cites a number of times when the base rents were reviewed and changed before the execution of the HAP.

Section 1.5(a) of the AHAP states:

> The initial Contract and Base Rent for each unit must be determined in accordance with HUD requirements. The Contract and Base Rents stated in Exhibit C will be the initial Contract and Base Rents specified in the Contract unless changes are made by the [PHA] in accordance with HUD requirements, including the correction of errors in computation of Base Rents or Contract Rents. Increases in Contract Rents during the rehabilitation period are permitted only with [PHA] approval, and only if the increases are consistent with HUD requirements.

Trafalgar was on notice, at the time of the AHAP execution, that the SHARP funds would be designated as a grant, and, therefore, deducted from the monthly debt-service calculations. The AHAP, however, allows for the change of that characterization in accordance with HUD policy without any request by Trafalgar.

HUD argues that, at the time of the AHAP execution, Trafalgar was aware of the *HUD policy* to treat SHARP funds as grants and not as loans. It points to the fact that, in the rent calculations it used to approve the rents to be included in the AHAP, the SHARP funds were characterized as grants. As a result, section 1.5(a) of the AHAP could not result in a change of HUD's characterization of the SHARP funds, because any change would be a violation of HUD policy.

There is no evidence, however, that HUD's treatment of the SHARP funds was pursuant to any actual policy. HUD points to the fact that it had treated SHARP funds as grants for previous housing projects. The past treatment of SHARP funds, however, does not establish a policy, per se. In fact, it appears from the record that HUD made an individualized decision to characterize the SHARP funds for the Project as a grant. It used past practice as support for that decision, but it was not bound by it as a policy.

The AHAP, by its plain language, allowed HUD to change its characterization of the SHARP funds at any time prior to the execution of the HAP. Here, the HAP was executed less than six years prior to the filing of Trafalgar's complaint. Trafalgar's objection to HUD's characterization of the SHARP funds, therefore, is not barred by the statute of limitations.

B. Merits

Under the Administrative Procedures Act ("APA"), 5 U.S.C. §§ 701 *et seq.*, this court must examine HUD's classification of the SHARP funds under the deferential "arbitrary and capricious" standard. 5 U.S.C. § 706(2)(A).

The funds dispersed pursuant to the SHARP program are meant to "facilitate the construction or rehabilitation of rental housing projects in locations where there is a need for such housing." Mass.Gen.L. ch. 23B § 27. The SHARP funds dispersed for the Project will be paid out annually over a fifteen year period. The principal and interest are to be repaid on December 1, 2016. Under Massachusetts law, it is not necessary for the principal to be repaid in cash. *Id.* It may be "recycled" into benefits for the tenants of the Project. *Id.*

HUD contends that two factors make its classification of the SHARP funds reasonable– that the funds need not be repaid until after the term of the HAP, and the "recycling" option.

This court finds that neither of these facts changes the obvious character of the SHARP disbursement from a loan to a grant.

HWLP entered into a contract with EOCD to receive SHARP funds. That contract is independent of the HAP. This court finds little relevance that the termination of the SHARP contract and the eventual repayment of funds occur after the termination of the HAP. Perhaps if the funds were to be repaid in an extremely lengthy period of time, there would be more credence to HUD's argument. But a thirty year mortgage is not unusual. HUD would not argue that a homeowner who takes out a thirty year mortgage has received a gift from the bank and not a loan. This court refuses to adopt HUD's flawed reasoning.

This court also will not accept HUD's erroneous argument that the "recycling" of HWLP's payments creates a grant and not a loan. The court can find no authority for HUD's contention that the "recycling" provision required by the SHARP statute could result in HWLP never paying back the principal of the loan. In fact, the SHARP statute expressly provides that "MHFA shall not waive any loan in whole or in part." Mass.Gen.L. ch. 23B § 27. It is entirely unreasonable to suggest that, because the eventual recipients of HWLP's repayment are the tenants of low and moderate income housing, HWLP is not, in reality, paying back the loan's principal.

This court holds, therefore, that HUD's classification of the SHARP funds as a grant, as opposed to a loan, was arbitrary and capricious.

VI. *REHABILITATION COSTS*

On February 5, 1986, the parties met to resolve the problem caused by HWLP's commencement of the rehabilitation of the Project before the execution of the AHAP.

HWLP wanted the cost of the pre-AHAP rehabilitation to be used in the calculation of the base rents. At the meeting, the parties agreed to use costs incurred prior to February 8, 1986 in the calculation of the base rents. The parties disagree as to how that calculation was to be made.

HUD states that it agreed to consider the pre-February 8 costs in the calculation of the Project's cash equity, and that it did just that. HUD contends that Trafalgar seeks the inclusion of the costs of financing the rehabilitation in the base rents, and that such a calculation would be inappropriate and in violation of HUD regulations.

The base rents are calculated in order to allow the property owner to recoup the cost of purchasing, maintaining, and improving the property. HUD Handbook 7420.3 Appendix 31. Having agreed to use pre-February 8, 1986 expenditures in the calculation of base rents, HUD now attempts, for all intents and purposes, to void that arrangement by drawing a distinction between money HWLP had on hand independent of the rehabilitation of the Project, and money it had to borrow for the purpose of rehabilitation. This court holds that such a distinction, in this case, is "arbitrary and capricious" pursuant to the APA. 5 U.S.C. § 706(2)(A).

Prior to February 8, 1986, HWLP paid $1,648,910 in order to rehabilitate the Project. The base rents, in order to account for that cost, must include that expense. The source of the funds is irrelevant. HWLP spent the money for the rehabilitation of the Project, and such an expenditure should be considered in the calculation of the Project's rents.

VII. *DEBT-SERVICE CONSTANT*

In addition to the SHARP loan, HWLP received a loan from MHFA. The parties agree that HUD used an improper debt-service constant for the loan while calculating the contract rents for the Project. The parties, however, disagree on whether any change is required in the contract rents for the Project on account of HUD's error.

Section 1.5(a) of the HAP reads:

> The initial Contract and Base Rent for each Contract Unit are stated in Exhibit A. These rents are subject to post-audit and change in accordance with HUD requirements, including the correction of errors in computation.

Trafalgar contends that a change in the debt-service constant is a "correction of errors in computation." HUD disagrees.

HUD relies on *2225 New York Ave., Ltd. v. Cisneros*, 842 F. Supp. 924 (N.D.Tex. 1994), *aff'd.*, 38 F.3d 210 (5th Cir.1994), for the proposition that this debt-service change would not fall under section 1.5(a). In *2225 New York*, HUD attempted to roll back the contract rents of an MRP project. It based its decision on corrections made by a review team four years after all rehabilitation work was completed.

The *2225 New York* court does say that, "four years after the fact would be too late as a matter of law for a 'post-audit' under authority of § 1.5.A." *2225 New York*, 842 F.Supp. at 931. *2225 New York,* however, is easily distinguished from the case presently before this court. There, the change in question was a change in judgment. *Id.* Here, the challenged HUD action is a pure error in calculation, not judgment. This court believes there to be a great difference in reversing a "judgment call"

four years after the fact, and changing a debt-service constant in order to conform with the law.

This court holds, therefore, that the HAP authorizes HUD to correct the debt-service constant on the MHFA loans, and to increase the Project's rents accordingly. HUD's refusal to do so, therefore, is "arbitrary and capricious" under the APA. 5 U.S.C. § 706(2)(A).

VIII. *EXCEPTION RENTS*

On February 19, 1984, the Regional Administrator for HUD approved a contract rent higher than normally permitted. He granted an "exception rent" pursuant to the HUD Handbook 7420.3. HUD now alleges that the decision was improper. It is HUD's contention that, even if the extra rehabilitation costs and the debt-service constant are counted against HUD, the revocation of the allegedly improperly granted exception rent more than makes up for the errors.

Trafalgar makes a number of arguments as to why the Regional Administrator's decision is now binding on HUD—regardless of the propriety of the decision. One, however, is particularly compelling. Trafalgar contends that 42 U.S.C. § 1437f(c)(2)(C) bars HUD from revoking the exception rent.

The pertinent part of 42 U.S.C. § 1437f(c)(2)(C) reads:

> The Secretary [of HUD] may not reduce the contract rents in effect on or after April 15, 1987, for newly constructed, substantially rehabilitated, or moderately rehabilitated projects assisted under this section . . . unless the project has been refinanced in a manner that reduces the periodic payments of the owner.

To offset the required correction of other errors, which would result in an increase of the contract rents, by lowering the exception rent would be a lowering of the contract rent. If HUD did not correct the exception rent, and the other errors were fixed, the contract rent would be higher. Consequently, keeping the contract rent at its current level, after the recognition that corrections require it to be higher, is a de facto lowering of the contract rent from the level at which it should be set.

Trafalgar, therefore, argues that HUD is attempting to reduce the contract rent in violation of 42 U.S.C. 1437f, which only allows a reduction when a project has been "refinanced in a manner that reduces the periodic payments of the owner."

In other circuits, courts have read section 1437f to limit HUD greatly. *2225 New York*, 38 F.3d 210; *Foxglenn Investors Limited Partnership v. Cisneros*, 35 F.3d 947 (4th Cir.1994); *Terrace Housing Associates, LTD. v. Cisneros*, 32 F.3d 461 (10th cir.1994). In all three cases, HUD attempted to lower the contract rents to correct "errors" in the initial contract rents. All three courts held that the plain meaning of 42 U.S.C.§ 1437f(c)(2)(C) barred such a correction.

HUD argues that if it is barred from offsetting the changes with a lowering of the exception rents, HWLP will be charging rents greater than the law allows. This court disagrees. The law allows HUD to grant exception rents. The law allows and requires the parties to determine the contract rents. The law allows and requires the correction of certain errors in the parties' calculations. The law, however, does not allow HUD to lower rents it initially granted, even if it did so improperly.

This court holds that the plain language of 42 U.S.C. § 1437f(c)(2)(C) controls in the present case. HUD may not, therefore, offset the increase in Project rents due to the additional rehabilitation costs and the correction of the

debt-service constant, with a reversal of the Boston Regional Administrator's decision to grant exception rents.

IX. *CONCLUSION*

For the reasons stated above, the court ALLOWS in part and DENIES in part Trafalgar's motion for summary judgment, ALLOWS in part and DENIES in part Defendants' motion for summary judgment, and declares the following: (1) Trafalgar's allegation that HUD should have used FY 1986 FMRs is time-barred; (2) HUD's decision to classify SHARP funds as a loan was arbitrary and capricious; (3) HUD's failure to include all of the pre-February 8, 1986 rehabilitation costs in its calculation of the Project's contract rents was arbitrary and capricious; (4) HUD's decision not to correct the debt-service calculations was arbitrary and capricious; and, (5) HUD may not offset required rent increases with a reversal of its Regional Administrator's decision to grant exception rents.

An order will issue.

/s/ Joseph L. Tauro

Chief, U.S.D.J.

ORDER

JULY 16, 1997

The court hereby orders that the parties' motions for summary judgment are ALLOWED in part and DENIED in part, and declares as follows:

1. Plaintiff's claim that Defendants used the improper Fair Market Rents is time-barred;

2. Defendants' classification of SHARP funds as a grant rather than a loan is arbitrary and capricious under the Administrative Procedures Act (the "APA"), 5 U.S.C. §§ 701 *et seq.*;

3. Defendants' refusal to include all of Plaintiff's eligible rehabilitation costs incurred prior to February 8, 1986 is arbitrary and capricious under to [sic] the APA;

4. Defendants' refusal to correct the debt-service constant used to calculate rents for the Project is arbitrary and capricious under the APA; and,

5. Defendants may not offset the corrections of its errors in computation with the reversal of the HUD Boston Regional Director's decision of February 19, 1985 to grant exception rents for the Project.

IT IS SO ORDERED.

DATED: July 16, 1997

/s/ Joseph L. Tauro

Chief, U.S.D.J.

42 U.S.C. § 1437f(c)(1) provides:

(c) Contents and purposes of contracts for assistance payments; amount and scope of monthly assistance payments

(1) An assistance contract entered into pursuant to this section shall establish the maximum monthly rent (including utilities and all maintenance and management charges) which the owner is entitled to receive for each dwelling unit with respect to which such assistance payments are to be made. The maximum monthly rent shall not exceed by more than 10 per centum the fair market rental established by the Secretary periodically but not less than annually for existing or newly constructed rental dwelling units of various sizes and types in the market area suitable for occupancy by persons assisted under this section, except that the maximum monthly rent may exceed the fair market rental (A) by more than 10 but not more than 20 per centum where the Secretary determines that special circumstances warrant such higher maximum rent or that such higher rent is necessary to the implementation of a housing strategy as defined in section 12705 of this title, or (B) by such higher amount as may be requested by a tenant and approved by the public housing agency in accordance with paragraph (3)(B). In the case of newly constructed and substantially rehabilitated units, the exception in the preceding sentence shall not apply to more than 20 per centum of the total amount of authority to enter into annual contributions contracts for such units which is allocated to an area and obligated with respect to any fiscal year beginning on or after October 1, 1980. Proposed fair market rentals for an area shall be published in the Federal Register with reasonable time for public comment, and shall become effective upon the date of publication in final form in the Federal Register. Each fair market rental in effect under this subsection shall be adjusted to be effective on

October 1 of each year to reflect changes, based on the most recent available data trended so the rentals will be current for the year to which they apply, of rents for existing or newly constructed rental dwelling units, as the case may be, of various sizes and types in the market area suitable for occupancy by persons assisted under this section. Notwithstanding any other provision of this section, after October 12, 1977, the Secretary shall prohibit high-rise elevator projects for families with children unless there is no practical alternative. The Secretary shall establish separate fair market rentals under this paragraph for Westchester County in the State of New York. The Secretary shall also establish separate fair market rentals under this paragraph for Monroe County in the Commonwealth of Pennsylvania. In establishing fair market rentals for the remaining portion of the market area in which Monroe County is located, the Secretary shall establish the fair market rentals as if such portion included Monroe County. If units assisted under this section are exempt from local rent control while they are so assisted or otherwise, the maximum monthly rent for such units shall be reasonable in comparison with other units in the market area that are exempt from local rent control.

42 U.S.C. § 1437f(c)(2) provides:

(2)(A) The assistance contract shall provide for adjustment annually or more frequently in the maximum monthly rents for units covered by the contract to reflect changes in the fair market rentals established in the housing area for similar types and sizes of dwelling units or, if the Secretary determines, on the basis of a reasonable formula.

(B) The contract shall further provide for the Secretary to make additional adjustments in the maximum monthly rent for units under contract to the extent he determines such

adjustments are necessary to reflect increases in the actual and necessary expenses of owning and maintaining the units which have resulted from substantial general increases in real property taxes, utility rates, or similar costs which are not adequately compensated for by the adjustment in the maximum monthly rent authorized by subparagraph (A). The Secretary shall make additional adjustments in the maximum monthly rent for units under contract (subject to the availability of appropriations for contract amendments) to the extent the Secretary determines such adjustments are necessary to reflect increases in the actual and necessary expenses of owning and maintaining the units that have resulted from the expiration of a real property tax exemption. Where the Secretary determines that a project assisted under this section is located in a community where drug-related criminal activity is generally prevalent and the project's operating, maintenance, and capital repair expenses have been substantially increased primarily as a result of the prevalence of such drug-related activity, the Secretary may (at the discretion of the Secretary and subject to the availability of appropriations for contract amendments for this purpose), on a project by project basis, provide adjustments to the maximum monthly rents, to a level no greater than 120 percent of the project rents, to cover the costs of maintenance, security, capital repairs, and reserves required for the owner to carry out a strategy acceptable to the Secretary for addressing the problem of drug-related criminal activity. Any rent comparability standard required under this paragraph may be waived by the Secretary to so implement the preceding sentence. The Secretary may (at the discretion of the Secretary and subject to the availability of appropriations for contract amendments), on a project by project basis for projects receiving project-based assistance, provide adjustments to the maximum monthly rents to cover the costs of evaluating and

reducing lead-based paint hazards, as defined in section 4851b of this title.

(C) Adjustments in the maximum rents under subparagraphs (A) and (B) shall not result in material differences between the rents charged for assisted units and unassisted units of similar quality, type, and age in the same market area, as determined by the Secretary. In implementing the limitation established under the preceding sentence, the Secretary shall establish regulations for conducting comparability studies for projects where the Secretary has reason to believe that the application of the formula adjustments under subparagraph (A) would result in such material differences. The Secretary shall conduct such studies upon the request of any owner of any project, or as the Secretary determines to be appropriate by establishing, to the extent practicable, a modified annual adjustment factor for such market area, as the Secretary shall designate, that is geographically smaller than the applicable housing area used for the establishment of the annual adjustment factor under subparagraph (A). The Secretary shall establish such modified annual adjustment factor on the basis of the results of a study conducted by the Secretary of the rents charged, and any change in such rents over the previous year, for assisted units and unassisted units of similar quality, type, and age in the smaller market area. Where the Secretary determines that such modified annual adjustment factor cannot be established or that such factor when applied to a particular project would result in material differences between the rents charged for assisted units and unassisted units of similar quality, type, and age in the same market area, the Secretary may apply an alternative methodology for conducting comparability studies in order to establish rents that are not materially different from rents charged for comparable unassisted units. If the Secretary or appropriate State agency does not complete and submit to the

project owner a comparability study not later than 60 days before the anniversary date of the assistance contract under this section, the automatic annual adjustment factor shall be applied. The Secretary may not reduce the contract rents in effect on or after April 15, 1987, for newly constructed, substantially rehabilitated, or moderately rehabilitated projects assisted under this section (including projects assisted under this section as in effect prior to November 30, 1983), unless the project has been refinanced in a manner that reduces the periodic payments of the owner. Any maximum monthly rent that has been reduced by the Secretary after April 14, 1987, and prior to November 7, 1988, shall be restored to the maximum monthly rent in effect on April 15, 1987. For any project which has had its maximum monthly rents reduced after April 14, 1987, the Secretary shall make assistance payments (from amounts reserved for the original contact) to the owner of such project in an amount equal to the difference between the maximum monthly rents in effect on April 15, 1987, and the reduced maximum monthly rents, multiplied by the number of months that the reduced maximum monthly rents were in effect.

42 U.S.C. § 1437 f(e)(2) (1985) provides:

(e) Restrictions on contracts for assistance payments

(1) Nothing in this chapter shall be deemed to prohibit an owner from pledging, or offering as security for any loan or obligation, a contract for assistance payments entered into pursuant to this section: *Provided*, That such security is in connection with a project constructed or rehabilitated pursuant to authority granted in this section, and the terms of the financing or any refinancing have been approved by the Secretary.

(2) For the purpose of upgrading and thereby preserving the Nation's housing stock, the Secretary is authorized to make assistance payments under this section directly or through public housing agencies pursuant to contracts with owners or prospective owners who agree to upgrade housing so as to make and keep such housing decent, safe, and sanitary through upgrading which involves less than substantial rehabilitation, as such upgrading and rehabilitation are defined by the Secretary. The Secretary is authorized to prescribe such terms and conditions for contracts entered into under this section pursuant to this paragraph as the Secretary determines to be necessary and appropriate, except that such terms and conditions, to the maximum extent feasible, shall be consistent with terms and conditions otherwise applicable with respect to other dwelling units assisted under this section. Notwithstanding subsection (c)(1) of this section, the Secretary may, in carrying out the preceding sentence, establish a maximum monthly rent (for units upgraded pursuant to this paragraph) which exceeds the fair market rental by not more than 20 per centum if such units are located in an area where the Secretary finds cost levels so require, except that the Secretary may approve maximum monthly rents which exceed the fair market rentals by more than 20 but not more than 30 per centum where

the Secretary determines that special circumstances warrant such higher rent or where necessary to the implementation of a local housing assistance plan. The Secretary is also authorized to make assistance available under this section pursuant to this paragraph to any unit in a housing project which, on an overall basis, reflects the need for such upgrading. The Secretary shall increase the amount of assistance provided under this paragraph above the amount of assistance otherwise permitted by this paragraph and subsection (c)(1) of this section, if the Secretary determines such increase necessary to assist in the sale of multifamily housing projects owned by the Department of Housing and Urban Development. (The Program authorized by 42 U.S.C. § 1437f(e)(2), was eliminated effective October 1, 1991, but existing projects continue in effect. Pub.L. 101-625, § 289(a)(4), (b).)